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PENSIONS & July 10, 1989

Investment Age

The newspaper of corporate and institutional investing

Directed trades go abroad

Practice helping trim expenses

By Joel Chernoff

Faced with a shrinking level of domestic equity trades, some pension executives are directing a portion of their foreign brokerage to help pay off their consulting fees and other plan expenses.

Spearheaded by Frank Russell Co., Tacoma, Wash., more than 30 of its clients worldwide now are pursuing the practice, including such major funds as the $30 billion American Telephone & Telegraph Co. fund and the $2.5 billion Monsanto Co. pension fund.

If the practice becomes widely adopted, it will further cut pension administrative costs, possibly complicate the lives of international managers and their traders and cause some dislocations in the foreign brokerage communities as those who decline to rebate commissions lose business to those who do.

The business didn't exist two years ago but is expanding rapidly, explained Jan Twardowski, president of Frank Russell Securities Inc., Russell's brokerage arm.

"Last year, we did gross commissions of $2 million and will do roughly double" that level in 1989, Mr. Twardowski said. Russell's U.S. pension fund clients have about $20 billion invested abroad, so business still could expand considerably.

Others also are looking to international trading as a way to generate business. SEI Corp., Wayne, Pa., also permits clients to pay for performance measurement and manager search activities through international trading, but so far the response has been very limited, said Edward Loughlin, senior vice president.

Major U.S. fund executives have established budgets for commission rebates. But as domestic equity trading levels have decreased since the October 1987 market crash, pension funds have sought new avenues to make up the lost amount of commission dollars used to pay consulting, custodial and actuarial fees.

The major alternatives have been in foreign equities and domestic bonds, but the decline in recaptured commissions from domestic equities has led pension funds to look also at recapturing commissions from trades on financial futures and over-the-counter stocks.

"It's an ability to pay for some of the costs of the plan without increasing commission dollars," explained Al Wolfarth, assistant treasurer for St. Louis-based Monsanto, whose pension fund has 10% of its assets, or some $250 million, invested internationally.

Mr. Wolfarth and others said, however, the amount of commission dollars that can be garnered from interna-

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Burkes protests deals, is ousted

By Marcia Parker

MADISON, Wis. — The state attorney general and the state auditor are investigating allegations the State of Wisconsin Investment Board approved three questionable real estate investments involving a broker with political ties, and paid him hefty finders' fees but refused to disclose them.

The probe was sparked by complaints from Marshall Burkes, who served as executive director of the $16.4 billion state pension fund for almost two years. Mr. Burkes was terminated by the investment board June 23, two days after he complained to the state government officials who oversee the pension fund.

In an extensive memorandum to the state authorities, Mr. Burkes alleged the board approved three real estate deals involving M. William Gerrard, a lobbyist, former political leader and real estate broker in the city of La Crosse. Mr. Burkes alleged Mr. Gerrard exerted political pressure to gain board consideration of real estate projects for which he earned hefty finders' fees.

Mr. Burkes also challenged the practice of paying finders' fees to people such as Mr. Gerrard, who bring projects to the board, and then failing to disclose them, among other practices. He said he was threatened with the loss of his

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Photo by Tim Berger

Wisconsin officials are reviewing real estate deals involving the state investment board, which is based in the capital. The probe stems from charges made by Marshall Burkes, the former executive director.

L.A. County EAFE fund called too costly

By Steve Hemmerick

LOS ANGELES — An international index fund set up for the Los Angeles County Employees' Retirement Association as a low-cost way to mirror the Morgan Stanley Capital International Europe Australia Far East Index has been criticized for costing too much to construct and for failing to closely track the index.

The criticism came in a report prepared for trustees of the Los Angeles County fund by Barry W. Dennis, senior vice president of Callan Associates Inc., and Toby Westbrook, Callan's vice president of international consulting services.

Some trustees asked Callan to investigate what they thought was a discrepancy in the tracking of the new $450 million index fund managed by Chase Investors Management Corp., New York.

The fund lost almost half of its investment return for the first one-year period because of unusually high set-up costs, according to the report. Mr. Dennis said the fund lost just under $6 million because of what he termed the improper implementation of the index fund.

The index fund was set up in three stages — at the request of pension fund officials — which added to the costs, but the report indicated the costs still appeared unusually high.

Representatives of Chase Investors, which manages about $1 billion total in international equity index assets, disputed the findings, claiming Callan used poor methodology in reaching its conclusions.

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LATE NEWS

Retiree health gain projected

WASHINGTON — A proposal to allow employers to shift surplus pension assets to retiree health accounts would raise $3.2 billion during the next five years, enhancing its prospects for being attached to a tax bill Congress will draft this summer.

The Joint Committee on Taxation's revenue estimate is significantly less than the $6 billion revenue gain cited by the proposal's authors, the Coalition for Retirement Income Security, but erases Department of Treasury concerns the proposal would reduce revenue in the short run.

The $3.2 billion figure assumes 125% of current liabilities remain in the pension fund. Assuming a 150% funding cushion, which is favored by the Bush administration, would lower the revenue gain to $1.7 billion.

The proposal still faces obstacles from key legislators and the administration because it addresses pre-funding of retiree medical benefits for a narrow group of companies and employees.

Rep. Rod Chandler, R-Wash., believes any new revenue generated by the CRIS proposal should be dedicated to pre-funding retiree health benefits, an aide said. But that position will face opposition by members of Congress seeking to raise $5.3 billion in new revenue.

Howard Weizmann, executive director of the Association of Private Pension and Welfare Plans, Washington, said the new revenue estimates make the proposal "golden," and the big question is whether the funding cushion will be 125% or 150%.

McMahan, Mellon eye merger

McMahan Real Estate Advisors Inc., San Francisco, and Mellon Real Estate Investment Management Corp., Stamford, Conn., are hammering out a deal to combine their companies.

"We've been discussing this formally since early June," said John W. McMahan, president of McMahan. "The proposal is that we'd merge the entities. If we do merge, our plan is to dramatically expand our operations; we'd be expanding our research side, and expect to expand our asset management base."

No agreement is expected until the end of July. Among the issues are how much money would change hands, whether there would be a stock swap and what name the new company would use. A spokesman for Mellon declined to comment.

McMahan has $570 million in tax-exempt real estate assets; Mellon, $1 billion.

The $545 million Colorado Fire & Police Pension Association, Englewood, a client of Mellon until last month, hired McMahan because McMahan offered better service, said Richard Holck, assistant executive director of the Colorado fund. Mr. Holck said he would find the merger "very interesting."

Regan prods corporate funds

NEW YORK — New York State Comptroller Edward Regan, sole trustee of the $38.9 billion New York State & Local Retirement Systems, wants to know more about pension investment policies and corporate governance issues.

Mr. Regan has asked the Financial Executives Institute and the New York Business Council, both of which represent many of the country's biggest companies, to prod their members into providing information on corporate pension investment policies and voting records on corporate governance and other issues.

Neither group so far has complied with the request. Mr. Regan said the system also would write the corporations directly and ask them to provide the information in their annual reports.

Mr. Regan's request grew out of his criticism of Gov. Mario Cuomo's Pension Investment Task Force, which he says sidestepped its mandate to probe the investment practices of both public and private sector pension funds, and to study trustee arrangements for public funds.

Methodists select Batterymarch

EVANSTON, Ill. — The $2.9 billion General Board of Pensions — United Methodist Church has hired Batterymarch Financial Management, Boston, to manage an undisclosed amount in an equity portfolio, according to an aide to Gale Whitson-Schmidt, United Methodist's chief financial officer. The aide said funding came from cash flow and did not involve the termination of a manager. She declined further comment.

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Questionnaires are in the mail

Questionnaires have been mailed for *Pensions & Investment Age*'s annual survey of master trust, master custodial and global custodial banks. In order to be included in the Sept. 4 directory, the questionnaires must be returned by Aug. 1. If you have any questions or have not received a questionnaire, please call Chris-

Economy cools off

Experts predicting no recession in '89

By Leonard J. Hollie

The economy is shifting from a period of rapid growth to one of more modest gains in the second half of 1989 and the first half of 1990, according to economists surveyed by *Pensions & Investment Age*.

Barring a massive federal bailout of the troubled savings and loan industry, few economists see an economic slowdown leading to a recession this year, but they think the chance of a recession occurring in 1990 is more likely.

On average, the panel of economists predicts growth in the gross national product of less than 2%, adjusted for inflation, through the end of the year, and little more than a 2% increase for the first half of 1990.

Two economists, Robert Dederick, chief economist at The Northern Trust Co., Chicago, and Lincoln Anderson, vice president and economist at Bear Stearns & Co., New York, were the least optimistic, both predicting only a 0.5% growth in real GNP for the second half of 1989. Mr. Dederick predicts 1% growth in the GNP for the first half of 1990; Mr. Anderson, 1.5%.

The most bullish prediction of real GNP growth for the second half of 1989 was 3%, by Edward Yardeni, chief economist at Prudential-Bache Securities Inc. He also predicted 3% growth in the first half of 1990.

Some economist see slow economic growth as a way to prevent inflation. "We are going to need a few quarters of negative GNP growth," said David Bostian, president of Bostian Research Associates, New York. "We want the economy to slow down, but not to slow enough to cause inflation."

The panel of economists also gave a lower probability of a recession starting in 1989 — 21% — than in 1990 — 36%. In their year-end 1988 outlook for 1989, the panel of economists, on average, predicted a 22% chance that a recession would start in 1989.

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Earnings produce concern

By Marlene Givant Star and Marcia Parker

Analysts and money managers are growing more concerned about what they say are clear signs the quality of corporate earnings is deteriorating, even though dividends are increasing at a rapid clip and profits were up during the first quarter.

Prospects for corporate earnings in 1990, meanwhile, hinge on the strength of the economy, with projections ranging from a moderate improvement to a sharp downturn in profits.

In an extensive report on corporate earnings, Stuart Robbins, managing director-research, and Eric Miller, chief investment officer at Donaldson, Lufkin & Jenrette, said analysts and investors must begin paying attention to the quality of earnings. Arguing that reported earnings have had less meaning, they urged DLJ analysts to review the changed quality of earnings in the industries they follow. The report cited developments in a variety of key industries that suggest the quality of earnings must be closely examined.

Variations in industry earnings performances are wider now than at any time in recent history, they said, and the profit growth of the Standard & Poor's 400 since 1984 could exemplify the worst quality on record.

Top 10 industries by analysts' earnings growth rate consensus

S&P industry sector	1989	1990	Average change in estimate in past 6 mos.
Other major banks	54.0%	12.0%	11.3%
Toys	49.2	16.8	11.9
Coal	47.5	25.9	7.9
Natural gas utilities	42.8	15.7	-7.1
Retail-specialty	41.7	18.8	0.9
Oil well equipment/services	34.9	44.4	-13.4
Misc. transportation	31.5	22.3	-11.5
Railroads	30.4	8.7	-5.4
Major regional banks	27.8	12.3	0.9
Airlines	27.2	-2.4	17.7

Bottom 10 industries by earning growth rates

Money center banks	-22.3	10.2	-4.2
Insurance brokers	-14.6	13.6	-4.4
Building materials	-10.8	9.0	-4.8
Gold mining	-8.2	18.0	-10.1
Manufactured housing	-2.6	1.9	4.8
Auto manufacturers	0.3	23.5	3.1
Broadcast media	0.9	12.6	-10.5
International oils	2.1	6.1	6.5
Electrical utilities	3.4	4.3	-1.2
Savings & loans	7	24.5	-13.0

Source: Institutional Brokers Estimate System

Looking at specific industries, the report said:

- Foreign-sourced and financially induced earnings now represent more than 25% of automobile industry growth.
- Structural changes suggest more volatile and lower quality earnings for wholesale/merchant banks.
- Profitability at consumer-oriented financial institutions could improve rapidly from the standpoint of quality and quantity.
- The use of stock options is contributing to a significant overstatement of current building materials earnings.
- The quality of earnings at conglomerates could be higher, especially in relation to a declining contribution from non-operating profits.

Analysts at Standard & Poor's Corp., New York, believe earnings for the S&P 500 Stock Index this year will rise 17% — less than half

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Wells deal to open doors

SAN FRANCISCO — The announced joint venture between Wells Fargo Investment Advisors and Nikko International Capital Management, Tokyo, will function more like a merger than a joint venture, according to Wells' chairman.

Wells Fargo & Co. announced June 28 it was spinning off its investment advisory group to the joint venture. Nikko Securities Co. Ltd., Tokyo, is paying Wells $125 million and will have a 50% stake in the joint venture.

Frederick Grauer, chairman of Wells Fargo Investment Advisors, said the joint venture, pending regulatory approval, will function "like a merger," one distinction to managers.

"Our deal is different from all of those," Mr. Grauer said. "It's a 50-50 split. It's worldwide, exclusive and has the economic incentives that both partners will experience the good and the bad in equal measure."

The venture, which is expected to be finalized and named in the fall, will be based in San Francisco and be headed by WFIA, Mr. Grauer said. Wells will handle the passive investment services offered by each, but no decision has been made so far as to how the venture will affect Nikko Capital Management (U.S.A.), New York, which handles both active and passive investments.

Mr. Grauer said the venture will allow each partner the opportunity to become "real and significant" players in the other's home turf. That is an important move for Wells, he said, because of openings expected in Japan's $142 billion institutional pension market. Only trust and insurance companies are allowed to manage the corporate pension assets now,

than $59 billion in U.S. tax-exempt assets under management. Nikko International Capital Management has about $11 billion in global assets under management, with $1.6 billion of that from its Nikko (U.S.A.) subsidiary, which has $364 million of U.S. tax-exempt assets under management.

Review recommended for endowments

WAYNE, Pa. — Endowment funds that increased their spending during the bull market should review their disbursement policies in light of the possibility of decreased investment returns, a new study said.

The study, by SEI Funds Evaluation Services, Wayne, Pa., said there is strong evidence investment returns in the near future will fall short of the averages experienced in recent years, when many endowments boosted their disbursements.

The 10-year period ended Dec. 31, 1987, was one of unusually high bond income, the study said. During the period, coupon income ranged between 7.5% and 13.5% a year, after having ranged between 2.5% and 7.5% from 1950 until the mid-1970s. Income peaked in the early 1980s and fell to about 9% in the five years ended Dec. 31, 1987. However, the decline may not indicate that rates are due to go back up again, considering the period's deviation from historical norms, according to the study.

Also, the bond income premium over inflation has averaged two percentage points for the past 35 years, as opposed to the 1987 premium of four percentage points.

Total return on equities, net of inflation, was about 7% a year for the past 60 years, compared with 23.5% annually for the five years ended Sept. 30, 1987. (This shortened period was used to assess performance before the October market crash.) In the year ended June 30, 1988, equities had an inflation-adjusted return of −11.5%.

"Assuming that returns for stocks and bonds will, over the long term, vary around the long-run averages, then return expectations for the next three to 10 years will be significantly lower than experienced over the last five years," according to the study, authored by Edward H. Asam, policy planning consultant.

As a result, spending policies that require disbursements of 6% or 7% of an endowment's assets each year might chip away at its principal, as they might exceed the real rate of return on investments.

Endowments spending more than their investments return have three options, according to the study — reduce spending; increase the size of principal through an aggressive development campaign; or adopt a more aggressive investment mix. During falling financial markets, however, the third approach presents an additional threat to principal.

In relation to spending policy, SEI looked at three formulas endowment sponsors might use — disbursements as a percentage of assets; disbursement of a fixed dollar amount increased by the rate of inflation each year; and disbursement of all current income.

For its initial simulations, SEI looked at a $1 million endowment fund with an asset mix of 60% bonds and 40% stocks, assumed rates of return using historical data from Ibbotson Associates, Chicago, and assumed 5% annual inflation.

Under such a scenario, disbursements of more than 4% a year would deplete the endowment's purchasing power over time, the study said. A 6% annual disbursement rate, fairly common, would cause the principal to lose 19% of its value over 10 years. Constant-dollar disbursements showed the same effect.

Naturally, a different set of investment returns would show different results, but the important point is that a spending policy must be established within a framework of expected investment returns, the study said.

Many endowments restrict their disbursements to current income. Such a policy, however, might affect the asset mix. It could drive down equity commitments and may direct investment style toward the high-yield sector in both equities and bonds. Also, an emphasis on high cash income would exclude from consideration high-return, low-current-income asset classes such as small-capitalization and growth stocks, venture capital and certain real estate vehicles.

Under another set of simulations, using a $1 million fund with an asset mix of 50% stocks and 50% bonds, SEI looked at the effects of spending all current income, which would be close to 5% of assets per year; spending a fixed rate of 5% per year; and spending $50,000, increased by the rate of inflation, per year.

These simulations indicated that disbursing a fixed dollar amount, adjusted for inflation, offers institutions the simplest method of budgeting and the highest expected disbursement amounts, with acceptable principal growth. The key to such a policy is to start with a dollar amount that is low enough to be sustained over time, the study said.

SEI also recommended modifying this policy by putting a cap on the amount to be disbursed in a given year, with the cap based on a percentage of assets. ■

Managers missed PIPER cutoff

Editor's note: *The following investment managers missed the deadline for inclusion or were incorrectly identified in the May 15 and May 29 listings of Pensions & Investments' Performance Evaluation Report for periods ended March 31. This information was provided by Lynn McBlaine of Rogers, Casey & Associates, which compiles PIPER.*

• **Manufacturer Life of Ontario**'s equity fund returned a compound annualized 22.3% for the 10-year period, placing in the top quartile. Its fixed-income fund returned an annualized 13.15% for the five-year period, also placing in the top quartile.

• **General American of Missouri**'s Separate Account 8, a fixed-income fund, returned 1.73% for the first quarter; its Separate Account 9, also a fixed-income account, returned 2.22% for the first quarter, 9.12% for the year, an annualized 8.45% for three years and 13.59% for five years. General American's equity index fund returned an annualized 11.43% for the three-year period. These figures place both fixed-income accounts and the equity index fund it the top quartile for these periods.

• **NCNB National Bank of North Carolina**'s equity account was incorrectly identified for the one- and five-year periods. The fund returned 19.1% and 11.9% respectively, placing it in the top quartile for those periods.

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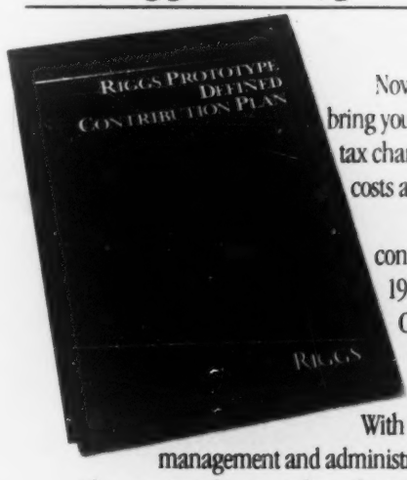

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L.A. County eyes co-investments

By Steve Hemmerick

LOS ANGELES — Trustees for the $9 billion Los Angeles County Employees' Retirement Association are considering investing $100 million in a realty co-investment fund that could cut investment management fees in half.

The fund — Core Group Trust, offered by Lehndorff & Babson Real Estate Counsel, Dallas — already has commitments of $100 million each from the $3.7 billion City and County of San Francisco Retirement System and the $3.2 billion Public Employees Retirement System of Nevada. In addition, trustees for the $3.2 billion Kansas Public Employees Retirement System are close to placing $100 million in the fund.

A co-investment fund is a cross between an individual, or separate, account and a commingled fund in which pension funds can save money and avoid some recurring hassles if they group together before buying trophy properties they couldn't afford to buy separately.

Indeed, the price of investment-grade property is what has prompted the Los Angeles County fund to consider co-investing rather than direct, separate investments.

Susan Barlow recommended a co-investment vehicle for the Los Angeles County fund.

The pension fund's consultant — Susan Barlow, managing director and vice president of Callan Real Estate Services — told trustees that even with $9 billion in assets, the fund might be better off investing in a co-investment fund such as Core Group Trust specifically for public funds or Core Property Trust, a real estate investment trust for corporate and public pension funds and foreign institutional investors managed by The Yarmouth Group, New York.

Ms. Barlow said Core Group Trust would charge investment management fees of 65 basis points, about one-half the usual fee for real estate investment management, and would buy the large properties pension funds need for their core real estate holdings. (Core holdings generally are the larger urban office and retail properties that dominate other buildings in a market and frequently cost between $100 million and $500 million.)

She said the Los Angeles fund could commit $100 million this year to core real estate investments and another $100 million in 1990 to meet its current core real estate goal of 30% of its total real estate holdings. The fund has set a target real estate allocation of 10% of total assets.

The core holdings would complement the fund's current property investments, which total $186 million. Of that amount, $138 million is in specialized real estate commingled funds.

In a separate interview, Ms Barlow said many pension funds smaller than Los Angeles County's do separate account investing in real estate and buy a share in large properties. But when they buy a stake in large properties without a co-investment fund structure, she said, each investment requires setting up a new partnership, which means increased legal and document fees and renegotiation of their rights as a partner with other investors.

In a co-investment fund, she said, many of the costs are paid only once.

Another advantage of co-investing is greater control for the pension fund participants. In the Core Group Trust, Ms. Barlow said, greater authority is given to pension fund officials than in an ordinary commingled fund, including the right to replace the manager.

Ms. Barlow had advised officials for the San Francisco and Nevada funds to form the group trust when she was a consultant with Pension Realty Advisors in 1988, before joining Callan.

She said the trust will mirror a separate account and have a 50-

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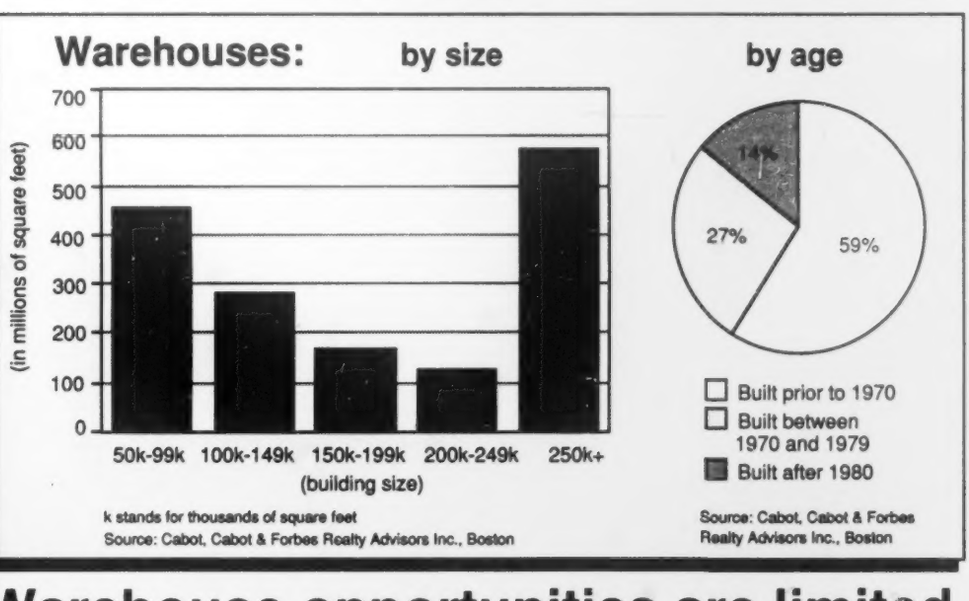

k stands for thousands of square feet

Source: Cabot, Cabot & Forbes Realty Advisors Inc., Boston

Source: Cabot, Cabot & Forbes Realty Advisors Inc., Boston

Warehouse opportunities are limited

Less than half — 41% — of the nation's warehouse market has potential for investment, a survey prepared for Cabot, Cabot & Forbes Realty Advisors Inc., Boston, has found. The survey also showed that most of the warehouse space is small or large, with 28% of the buildings 99,000 square feet or less and 36% 250,000 square feet or more. In addition, 59% of the space was built prior to 1970.

2 shine bright in U.K. market

By Holly Smith

LONDON — A strong economy and a post-crash shift of assets out of the stock market and into real estate resulted in a stellar year for U.K. property investors, with total returns for institutional investors for the year averaging 29.8%.

A few property fund managers were able to make even these impressive figures — measured by the London-based Investment Property Databank, a real estate research firm — look paltry by posting total returns of more than 45% for the year ended Dec. 31.

While it is hard to compare the performance of the various property fund managers because many of the major players don't make their results public, two of the men whose names often come up when real estate specialists are asked to list the best are Nigel Wiggins, director of property investment services for Kleinwort Benson Investment Management Ltd., and Bernard High, property investment manager for the Clerical Medical Investment Group.

Mr. Wiggins and his team were one of the top performers among pooled pension property funds, with a total return of 47.9% for its commingled property fund. Clerical Medical does not make its figures public, but real estate industry insiders say its results are excellent.

Both executives believe much of their success is the result of not being too deeply involved in real estate.

Mr. Wiggins, for example, says probably the most important part of his education was the two years he had off before getting his social science degree and gaining his chartered surveyor qualifications. He came into the property world late, but with a broader outlook.

Another key advantage is the scope of his job, which includes being a research analyst for Kleinwort Benson Investment Management, and advising the equity fund managers on which property company shares they should buy. "It's unusual for people running direct property to also be looking at property shares," he explained. Real estate agents "are looking backwards because they are looking at historic deals. The (stock) analysts have to look forward."

Mr. High gives the most credit for his success to his broad academic background. "I'm one of

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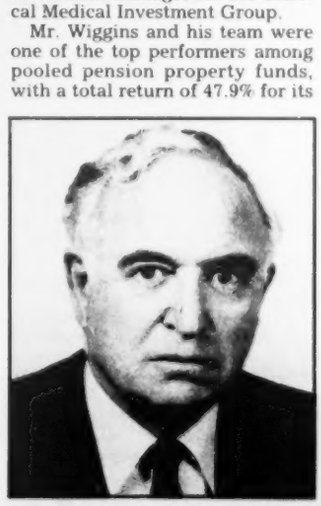

Clerical Medical's Bernard High, left, and Kleinwort Benson's Nigel Wiggins frequently outperform other U.K. real estate investors, according to industry experts.

UPDATE

Investments to surge

LOS ANGELES — Pension fund ownership of U.S. real estate is expected to swell to $300 billion by the year 2000, with an additional $20 billion expected each year until that time from foreign investors, Arthur Andersen & Co. reports.

U.S. pension funds currently have between $70 billion and $80 billion in equity real estate investments.

The projections were contained in the first of a six-part series of articles written Ivan Faggen, worldwide director of the Arthur Andersen's Real Estate Services Group.

For his estimates, Mr. Faggen assumed a 10% allocation to real estate by pension funds and a growth in total pension assets to more than $3 trillion, from the current level of about $2 trillion.

Pension investors, however, might find it difficult to invest that vast sum, Mr. Faggen wrote.

Only about $15 billion of new office buildings and even less of other income-producing properties are built annually, he said. In fact, he noted available capital "may be as much as 30 times the supply" of institutional-grade properties.

As a result, Mr. Faggen thinks more pension funds will become more adventuresome in real estate as their sophistication grows, possibly making investments with development or lease-up risks.

Office venture set

CHESAPEAKE, Va. — Two Chesapeake, Va., office towers were bought for $23.2 million in a joint venture of limited partnerships sponsored by USF&G/Legg Mason Realty Partners and Fidelity & Guaranty Life Insurance Co.

Each limited partnership has a 50% stake in the buildings. The joint venture has executed a letter of intent for $13.1 million in permanent financing from an unidentified lender.

Retail center is sold

PALMDALE, Calif. — Palmdale Place shopping center here was purchased for $11.2 million by Bonutto Hofer Investments and Dover Investment Properties. The seller was a joint venture of Riley/Pearlman Co. and Downey Savings & Loan.

The 164,000-square-foot center, developed in 1986 by Riley/Pearlman, is anchored by Albertson's supermarket, Thrifty Drug and H&E home improvement.

Advisory unit formed

CHICAGO — Amli Realty Co. has formed a wholly owned subsidiary — Amli Institutional Advisors Inc. — to offer investment services and products to pension

Continued on page 31

FINANCING

Stock redemptions skyrocket

By Marlene Givant Star

Corporations redeemed more securities than they raised in the debt and equity markets combined in the first quarter, for the first time since World War II.

During the January to March period, net stock redemptions at an annual rate of $180 billion exceeded the $174.6 billion of net monies raised in the debt markets. As a result, corporations returned $5.4 billion more in monies to investors than they took out through borrowing and stock offerings.

The figures were released by the Federal Reserve Board.

The accelerated rate of corporate redemptions since the fourth quarter of 1986 corresponds with the period's surge in takeover and leveraged buy-out activity. The first-quarter figures in particular reflect the consummation of the massive leveraged buy-out of RJR Nabisco Inc. Corporate share repurchase programs, another source of redemptions, were not a major factor in the first quarter but were widely used by companies to restore investor confidence following the 1987 market crash (*Pensions & Investment Age*, Nov. 2, 1987).

"By putting more funds back to the markets than they are taking out, corporations are fueling the massive buildup of liquidity in the financial system and reinforcing the excess of demand over the new supply of debt and equity instruments," noted Robert A. Schwartz, vice president and senior financial economist of Merrill Lynch Capital Markets, in an analysis of the Federal Reserve results.

Since the beginning of 1984, corporations have been the largest source of demand in the equity markets, redeeming a net $414.3 billion of outstanding stocks through acquisitions, leveraged buy-outs and share repurchases.

For the first three years of the acquisition boom, corporations borrowed heavily to finance stock redemptions, driving up outstanding corporate debt by 15.8% in 1984, 11.5% in 1985 and 12% in 1986. But the huge increase in supply of corporate debt did not prevent interest rates from falling because of the corresponding increase in demand for fixed-income investments from overseas investors as well as U.S. mutual funds, insurance companies, pension funds and households, Mr. Schwartz said.

Just as stock redemptions generated a huge increase in borrowing needs, they also enlarged the pool of monies available to finance those needs. Investors have largely reinvested the proceeds from stock redemptions in credit market instruments such as high-yield securities, commercial paper and other loans and investments that help finance the debt expansion associated with acquisition activity.

"In a sense, the takeover boom has been partially self-financing," Mr. Schwartz said.

In 1986, non-financial corporations raised $202.1 billion in the debt markets and redeemed $80.8 billion of outstanding stock, resulting in a net call, or net monies raised in debt and equity markets, of $121.3 billion.

But the volume of net funds raised in the debt and equity markets has been on a steep downtrend since the fourth quarter of 1986 when it reached a peak annual rate of $174.5 billion. In 1987, the net call on the markets fell to $68.5 billion and by the fourth quarter of last year, it had fallen to an annual rate of $32.8 billion.

Proceeds from stock redemptions are boosting the market's supply of liquidity while the pace of corporate debt expansion is slowing as evidenced by its meager 7.8% annual increase in the first quarter. Mr. Schwartz believes this positive demand-supply balance will persist and provide staying power to the current rally in the fixed-income market.

Even if stock redemptions subside with an expected reduction in takeover activity, corporate debt growth will continue to decelerate as economic activity slows, he said.

Meanwhile, the supply of funds is rising from the rapid growth in interest receipts generated by the huge buildup of debt holdings during the 1980s and any falloff in stock redemptions will be replaced with proceeds from debt redemptions, he added. ■

Global issuers score big in first half

By Marcia Parker

NEW YORK — For the first time ever, the volume of new issues done abroad almost equaled what was raised in the U.S. markets, signaling issuers' growing comfort with, and willingness to try, tapping capital markets worldwide.

Statistics for the first half of the year show corporate issuers increasingly are going global as they search the world's capital markets for the right financing opportunities. Japanese investment bankers, relative newcomers, are winning more and more of the business.

During the first six months of the year, the international marketplace experienced its greatest semiannual volume, with $134.2 billion raised by issuers worldwide, vs. $141.6 billion raised domestically, according to Securities Data Co., Newark, N.J.

Japanese investment banks and issuers led the rally abroad. Nomura Securities, with $21.2 billion, and Nikko Securities, with $12.8 billion, finished in first and second place. These two banks raised more in the first half of 1989 than they did in all of 1988.

Daiwa Securities Co. Ltd. and Yamaichi Securities rounded out the top four, with $10 billion and $9.3 billion, respectively. Japanese issuers accounted for 35.7% of the securities issued, more than doubling their market share during the first half of 1988.

Japanese investment banking executives in London said one reason international debt market volume soared was the huge number of Japanese companies issuing debt with equity warrants in the Eurodollar bond market. The Japanese investment banks, which are underwriting these offerings, are structuring financings that allow the companies to swap the proceeds into fixed-rate yen, thereby achieving low-cost yen financing.

In the first half, Nikko underwrote more than $3 billion in debt-with-equity-warrant offerings for Nippon Steel, Mitsubishi Heavy Industries and Mitsubishi senior manager-corporate finance, The Nikko Securities Co. (Europe) Ltd., London, said Japanese companies are going to market because they are making sizable capital investments at home in response to the shift in the economy from being driven by exports to being driven by domestic demand. In addition, investor demand for the securities has soared.

"The Japanese debt-with-equity-warrants market has been a phenomenon unto itself due to what has been perceived as the remarkable strength of the Japanese equity market, which led to both unique financing opportunities for Japanese corporations and an unusual climate for Japanese and other international investors," said Jan McCourt, senior associate director, Daiwa Europe Ltd., London.

He noted the Japanese securities firms are getting more aggressive in attracting and winning business from non-Japanese corporations.

"There's been an increasing internationalization of the role of the Japanese investment houses," Mr. McCourt said, adding they are underwriting more generic issues and proprietary product offerings for non-Japanese corporations and placing more of the securities with non-Japanese investors.

The U.S. debt market also was flourishing in the first half. Propelled by a downward trend in U.S. interest rates and a strong dollar, corporations issued $72 billion of debt during the first six months of 1989, the highest level of straight debt offerings to the U.S. markets in three years.

Despite the surge, the total dollar volume of all debt and equity issues sold to the U.S. markets was close to 10% behind last year's pace, according to Securities Data.

The drop to $141.6 billion in new U.S. issues was due to a 44.8% drop-off in equity volumes from a year ago and the recent softness in the mortgage market. Fees continued to suffer because of the slide in equity issues, and are $660 million behind 1988's pace.

The dollar's new muscle, as well as rising interest rates abroad, brought to the international marketplace a wealth of dollar-denominated issues. About 59.5% of all Eurobonds were denominated in U.S. dollars during the first half of the year, compared with 38.8% in the first half of 1988.

The volume of international equities kept pace with first-half 1988 statistics, with $2 billion raised.

Although the Japanese are making great strides, their U.S. competitors are still the leaders.

Merrill Lynch Capital Markets again captured the top spot in the U.S. and global capital market rankings. In the United States, Merrill Lynch continued as the premier debt underwriter, underwriting $25.2 billion and gaining more than two market share points.

Merrill Lynch raised 91.3% of this capital using various debt instruments. Asset-backed securities and junk bonds were two areas in which Merrill Lynch gained considerable market share. The firm experienced an increase in overall domestic market share to 17.8% from 14.9% a year ago.

Merrill Lynch was the top underwriter globally as well, capturing 10.3% of the $274.9 billion global market. Credit Suisse/First Boston finished in second place globally, with $23.8 billion and a market share of 9%.

Goldman, Sachs & Co. and First Boston Corp. finished the first-half domestic standings still in a struggle for second and third place. Goldman, Sachs managed the books on $16.9 billion, while First Boston handled the books on $16.3 billion.

The straight-debt market, excluding mortgage and asset-backed securities, experienced its greatest half-year volume in the past three years, raising $72 billion. The recent decrease in interest rates caused a wave of issuers to bring longer term debt securities to market.

Merrill Lynch took top honors, raising $15.9 billion for a market share of 22.1%, the highest market share since the last half of 1985, when Salomon Brothers Inc. underwrote 24.1% of what was a $43.4 billion market.

Although Merrill Lynch and Goldman, Sachs have a considerable lead in this area, less than $2 billion separates Salomon, Shearson Lehman Hutton Inc., Drexel Burnham Lambert Inc., Morgan Stanley & Co. and First Boston, which rank third through seventh respectively.

Merrill Lynch's formula for success continues to lie with financial institutions, according to Securities Data. The bank raised 28.9% of the industry's total volume of $40 billion.

Although the Dow Jones Industrial Average rose 16%, common stock and initial public offering volume plummeted in the first half of 1989, according to Securities Data. Common stock volume totaled $8.9 billion, with 184 issues, 44.8% less than the $16.1 billion and 202 issues, brought to market during the first half of 1988.

Issuers of initial public offerings found a tough marketplace to raise capital. IPOs suffered a decrease of 52.9% from first half 1988's level of $12.9 billion. Only 100 companies went public so far this year vs. 138 companies in the first half of 1988. These firms raised just $6.1 billion, reflecting the fewest number of companies going public since the second half of 1982.

For the first time since the October 1987 stock market crash, industrial issuers returned to the IPO market. About $2.4 billion was raised by these companies, accounting for 41.1% of all IPOs. During the first half of 1988, the industrial issuers only accounted

International underwriting rankings

	Jan. 1-June 30, 1989			Jan. 1-June 30, 1988		
	Amount ($ mils.)	% of market	# of issues	Amount ($ mils.)	% of market	# of issues
Nomura Securities (2)	21,193.9	15.8	97	11,032	9.8	81
Nikko Securities (5)	12,800	9.5	37	5,712.7	5.1	38
Daiwa Securities (4)	9,981	7.8	54	6,772.3	6	55
Yamaichi Securities (9)	9,301.3	6.9	47	3,728.4	3.3	31
Credit Suisse First Boston/CS (1)	7,516.1	5.6	50	11,479.8	10.2	80
J.P. Morgan (11)	5,397.9	4	28	3,534.5	3.1	24
Deutsche Bank AG (3)	5,060.4	3.8	30	7,067.1	6.3	48
Bankers Trust (12)	3,947.5	2.9	50	2,861.1	2.5	25
Morgan Stanley (17)	3,906.3	2.9	31	2,038.9	1.8	20
Banque Paribas (8)	3,469.4	2.6	29	4,018.9	3.6	29
Union Bank of Switzerland (6)	3,164.4	2.4	25	4,912.9	4.4	41
Goldman, Sachs (18)	3,072.7	2.3	29	1,959.2	1.7	18
Merrill Lynch Capital Markets (13)	3,034.4	2.3	29	2,858.4	2.5	20
Industrial Bank of Japan (14)	2,138.5	1.6	27	2,380.4	2.1	25
Salomon Brothers (15)	1,935.6	1.4	17	2,224.5	2	17

All issues; full credit to book manager
Numbers in parentheses refer to first-half '88 rankings
Source: Securities Data Co.

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UPDATE

Investors to sell stock

PLEASANTVILLE, N.Y. — Analysts expect investors to have a strong interest in the non-voting Reader's Digest stock that will be sold in an initial public offering by a group of institutions late this year or early 1990.

Reader's Digest Association Inc., a privately held publishing company, said several institutions seeking increased liquidity and financial flexibility will sell at least 10% of the non-voting stock to the public. No price or underwriter was disclosed. A registration statement isn't expected until late this year or early next year.

The selling institutions include the Colonial Williamsburg Foundation, Williamsburg, Va.; Lincoln Center, Memorial Sloan-Kettering Cancer Center, the Metropolitan Museum of Art, the New York Zool Society, all in New York; and Macalester College, St. Paul, Minn.

Security analysts who follow the publishing industry say that although little is known about actual performance, Reader's Digest is a healthy, well-run, profitable company in a hot industry sure to attract investors.

Reader's Digest itself does not plan to sell stock in the offering. A substantial part of Reader's Digest non-voting stock is held by the DeWitt Wallace-Reader's Digest Fund and the Lila Wallace-Reader's Digest Fund. The Wallace's founded the company in 1922.

The balance of the non-voting stock is held by the foundations and a handful of employees.

All the voting stock is held by the two Wallace funds and an unidentified trust. They don't intend to sell any of the voting stock of the company. The two Wallace funds face new tax laws requiring them to reduce their holdings in the company to 50% or less by the year 2000. Reader's Digest said the two funds intend to continue to hold 50% of the voting stock to help insure the independence of the company.

In addition, changes will be made in the employee profit sharing plan to permit annual contributions to the plan of previously unissued voting stock. The company expects the plan will have acquired up to 20% of the voting stock by the year 2000.

Together with the 50% held by the two Wallace funds, that will ensure that control of Reader's Digest will remain in the hands of the family and employees, keeping it safe from raiders.

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Global

Continued from page 35

Sachs was the top manager of IPOs, capturing 21.6% of this arena, Securities Data said.

In the junk-bond market, RJR Nabisco Inc. made the largest junk bond offering to date with proceeds of $4 billion, pushing Drexel back into the forefront of the rankings. Drexel underwrote $6.8 billion of this $14.8 billion market, and close to three times the number of deals of any rival.

Junk bonds with an initial coupon of zero percent came into vogue in the first half of 1989. About $2.7 billion was raised using this technique where investors do not get paid any interest until maturity or a set date. In the first half of 1988, zero coupon junk bonds were used on $1.2 billion, according to Securities Data.

In the last six weeks, since RJR came to market, the junk bond arena has begun to revive. Twenty-five junk bond offerings for $3.9 billion have been issued. Eleven of these issues were book managed by Drexel, but the other 14 marked the return of Prudential Bache Capital Funding, Salomon, Kidder Peabody & Co. and PaineWebber Inc. to this marketplace.

Mortgage and asset-backed securities experienced a slow spring season, bringing their first-half volume to $55 billion, a 2.6% decrease from the same period last year. First Boston, with $8 billion, and Bear Stearns & Co., with $7.1 billion, were the leaders in this area.

Goldman, Sachs and Salomon Brothers, 1988's leaders, fell to sixth and fourth place, respectively. ■

FEATURE

Lending puts assets to work

By Suren Singhvi

At many corporate pension funds, treasurers have a pile of assets idle, earning absolutely nothing. It's an odd practice, considering no corporate treasurer would hold cash even overnight without earning interest. But many sponsors fail to take advantage of the incremental, virtually riskless return available by lending stocks and other securities they keep with their custodians.

Of course, a pension fund committee must authorize the program. But a treasurer who appreciates the earning power of those idle assets can influence the committee to adopt such a program, outlining arguments in its favor.

A sponsor normally can earn sufficient income from the program to pay a significant portion of its trustee's or custodian's fee without adding any additional work for the corporation's treasury staff. The amount depends on the mix of securities lent.

A $1 billion pension fund might reasonably expect to earn about $500,000 a year by lending securities under the following scenario. The fund, whose assets are allocated 50% to domestic equities, 35% to bonds and 15% to government securities, cannot lend all of its securities.

Some of the securities, such as commercial paper and mortgage-backed securities, are ineligible because they are held physically and cannot be electronically transferred. Other securities aren't in demand.

As a result, only $180 million of the $500 million in equities, $300 million of the $350 million in bonds and $100 million of the $150 million in government securities are attractive to securities borrowers. But at any time, the pension fund typically will have lent out only 10%, or $18 million of the eligible equities; 30%, or $90 million of the eligible bonds; and 40%, or $40 million, of the eligible government securities.

Returns on lending securities vary, but equities typically earn an annualized 0.5%, corporate bonds, 0.75%, and government securities, 0.6%.

In this scenario, the securities on loan would earn $1.004 million. The sponsor, splitting the proceeds with the trustee bank, would net $502,000 for a year.

Some sponsors may believe the program is too risky in today's economic environment. A registered broker could file for bankruptcy and not return the borrowed securities. A properly structured program, however, makes the trustee responsible for such risk.

Bankers Trust Co., New York, the bank I use for securities lending, has a significant program with $45 billion in lendable securities from 99 clients. On average in 1988, it had out on loan $7.65 billion a day to 65 brokers. The bank has never experienced any broker bankruptcy, nor has it ever failed to receive lent securities. It has experienced some failed trades due to lending, i.e., it was not able to retrieve the security from the broker in time to settle a sale. Such failed trades had no effect on the portfolio's performance because the trustee takes care of the losses.

The predominant reason trades failed was due to the investment manager's failure to deliver trade information to the trustee on the trade date.

The only risk with the program is if the trustee files for bankruptcy. If that happens, the entire pension fund is at risk regardless of the securities lending program.

The program, thus, has no incremental risk in my opinion.

The demand for securities arises from investors who "sell short," or sell a security they do not own but plan to buy in the future. Securities lending doesn't interfere with a sponsor's investment managers' purchases and sales. The trustee assumes the responsibility for making sure the securities will be ready for delivery if the manager trades the securities.

The trustee handles the program, lending securities through registered brokerage firms, selected on their financial health. Once selected, the trustee ought to continue to monitor these brokerage firms. Bank trustees typically offer similar programs to limit a pension fund's risk and to make a sponsor's lendable portfolio more attractive.

Foreign securities lending offers a further opportunity. For example, a number of U.S. banks now lend Japanese equities to both the United States and U.S.-based Japanese brokerage firms for delivery in Japan. Although the program is still relatively small, it has been extremely profitable. The average loan spread is five times more on international than domestic securities. ■

Mr. Singhvi is vice president and treasurer of Edison Brothers Stores Inc., St. Louis, and adjunct professor of finance at Miami University, Oxford, Ohio.

Change in use of securities lending

	1988	1986	1984
Corporate pension funds overall	**18%**	**17%**	**15%**
Over $1 billion in assets	53	46	39
$501-1,000 million	30	35	31
$251-500 million	28	28	30
$101-250 million	13	12	15
$50-100 million	2	7	20
Under $50 million	5	4	4
Public	**30**	**22**	**NA**
Over $1 billion	55	47	NA
$251-1,000 million	39	37	NA
$101-250 million	22	27	NA
$50-100 million	9	2	NA
Under $50 million	6	3	NA
Union	**25**	**NA**	**NA**
Over $1 billion	70	NA	NA
$1 billion and under	15	NA	NA
Endowments/foundations	**30**	**22**	**NA**
Over $1 billion	26	11	NA
$250-1,000 million	43	44	NA
Under $250 million	20	44	NA

Source: Greenwich Associates, Greenwich, Conn.

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Earnings create

Continued from page 2

of last year's 35% gain. Yet dividends are increasing at their fastest pace in 22 years and should be up 13% this year as companies begin to return to shareholders some of the more than 90% in compounded profit gains during the past three years, according to Arnold Kaufman, editor of S&P's The Outlook, which analyzes and projects business and market trends.

"We think that increase could be shaved as the year wears on because companies don't anticipate specific writeoffs in advance," he said.

For the entire S&P 500 index, the consensus among analysts is for 10.6% growth by the end of this year and 8.3% growth in 1990, according to Stanley Levine, vice president of Lynch, Jones & Ryan, New York, which owns the Institutional Brokers Estimate System, which tracks earnings projections of 2,436 analysts worldwide.

Data on the second quarter won't be released by the Commerce Department for several weeks. But based on first-quarter data, Wall Street analysts are calling for a gain for the S&P 500 of 5% to 20% for 1989, with a 10% advance to more than $26 for the average share price of stocks in the S&P 500.

Forecasts for 1990, however, are spread over a broad range. Economists who expect a recession project per-share net for the S&P 500 to decline 20% while the most optimistic analysts look for a gain of more than 10%.

Drexel Burnham Lambert Inc.'s new estimates for the S&P 500 are $27.50 for 1989 and $24 for 1990. Drexel's forecast — lower than the consensus — noted its latest 1990 estimates are higher than before, but still represent a significant drop from 1989 profit levels. The firm believes the peak in earnings momentum already has occurred, and predicts a 15% increase in earnings in 1989 and a 13% decline in 1990 for stocks in the S&P 500.

Merrill Lynch Capital Markets, New York, is forecasting S&P 500 earnings per share to rise by 5% to $25 in 1989.

Merrill Lynch's latest outlook noted corporate profits after taxes, as reported by the Commerce Department, edged down in the first quarter of 1989, even though they remained 15% above the year-earlier level and corporate profits before taxes of non-financial companies rose to a new high of $248.1 billion in the first quarter (about 8.6% higher than last year).

Merrill's Robert Schwartz, senior financial economist, contends the Commerce Department numbers overstate momentum. He says inventory profits rose sharply in the first quarter and the quality of earnings deteriorated.

Operating profits plunged and were only 1% above the level a year earlier, he said, and profit margins have eroded since the end of 1984, which could intensify this year as economic growth slows and labor costs and interest expenses continue to mount. In the first quarter, operating margins were 8.5%, down from the peak of 10.8% in the second quarter of 1984.

And because labor costs are rising and interest expense is squeezing profits, Mr. Schwartz predicts the earnings environment will worsen as the year proceeds.

"Clearly profits are under pressure because of moderating demand, rising costs and sluggish productivity, but to make matters worse, the quality of business net income continues to deteriorate," said F.W. Hackenburg, a senior investment analyst at Credit Suisse Asset Management, New York.

He noted sharp price advances experienced by many commodities and products in the last 12 months not only will put pressure on profit margins but also will create inventory profits, which are non-operating earnings. This source of income rose to $23.8 billion in 1988 from $18 billion the year before.

Furthermore, he said, capital consumption adjustment (the difference between depreciation reported by the Internal Revenue Service and the Commerce Department's estimate of real appreciation) is declining. Companies prefer to account for depreciation expense as much as possible because it is a non-cash item that reduces taxes payable. Therefore, the amount of excess depreciation must be added to after-tax corporate earnings for a better indication of real or economic profits.

Mr. Hackenburg believes it will be difficult for many industries to register profit gains in 1990. Earnings per share of the S&P 500, he said, could be up or down by 5%. The firm now projects a 1% gain to $25.50.

He said the corporate profits picture for this year is much clearer. Credit Suisse estimates S&P 500 per share results will rise about 6% to $25.25. ■

Cool off

Continued from page 2

Three economists said the chance of a recession starting before the end of the year was virtually non-existent. David Levine, senior vice president at Sanford C. Bernstein & Co., New York, had the lowest prediction — 2% — of those surveyed. Lacy Hunt, chief economist at Carroll, McEntee & McGinley, New York, saw only a 2.5% chance, while John Hekman, senior economist at Claremont Economics Institute, Claremont, Calif., said there was a 5% chance.

Mr. Dederick, however, said there's a 50% chance of a recession in the last half of 1989. "The economy will slow down and interest rates will go up," he said. "We might not go into a real recession, but we have been on the border of a recession for a while."

Geoffrey Dennis, chief international economist at James Capel Inc., New York, saw only a 20% chance of a recession in 1989 but a 40% chance in 1990. "We believe that the economy is stronger at the moment than the general market believes. The classic signs of recession, such as high inventory levels and falling orders, are not in place at the moment," he said.

Generally, the economists do not see a sharp rise in inflation, forecasting it will reach 5% before the end of the year, and remain at 5% through the first half of 1990. The highest inflation rate projection came from Mr. Hunt, who predicted 6.5% through the end of the year, and 7.2% in the first half of 1990.

The dual threat of inflation and recession are the most pressing dangers economists see facing the economy.

A too strong dollar could lead the Federal Reserve Board to lower interest rates, which would increase consumer spending and could bring about inflation. Likewise, a too tight monetary policy would stall domestic demands and drive up interest rates.

"When a business cycle ends like the present one is doing, there is a possibility of a shock, accident or policy mistake that you can't predict," said Richard Rippe, senior vice president and economist at Dean Witter Reynolds, New York. He also is concerned a continued strong dollar could, by 1990, stop or reverse the recent trade improvement and weaken the economy. "I would reduce the federal budget deficit in a constant and steady fashion and give monetary policy a freer hand," he said.

Bear Stearns' Mr. Anderson said a too tight monetary policy would slow production growth and GNP. "The macroeconomics policy is operating pretty good right now," he said. "I would take my hands off the lever and work on microeconomics policy. I would go to work on deregulation and trade issues. Those would have much more of an effect in pushing up real GNP."

For the second half of 1989, the highest predicted yield on 30-year Treasury bonds is 9.2%, a forecast made by Mr. Levine, who also predicted a 9.6% rate for the first half of 1990.

The highest anticipated yield on 90-day Treasury bills was 8.8% in the second half of 1989 and 9.6% in 1990, also by Mr. Levine.

At the end of last year, Mr. Levine also was at the high end of the predictions for Treasuries, expecting 11.4% by year-end '89. The high at that time for T-bills came from Mr. Hunt, with 9.88%.

In December, the median projected yields for 30-year Treasuries and 90-day T-bills were 9.2% and 7.3%, respectively; the median projections for the second-half of this year are 8.5% and 8.05%, respectively.

Despite the improvement in the federal budget deficit that will come from lower interest rates and increased revenue, such as from taxes, most of those surveyed said decreasing the budget deficit still should be a priority.

"It's important that the budget deficit fall below $100 billion in 1990 to stabilize the dollar's value on the market and slow the escalation of the dollar," said Mr. Hunt.

The panel of economists, however, generally wasn't optimistic the $100 billion mark President George Bush set in this year's budget would be achieved.

Mr. Bostian forecast the most optimistic decrease in the federal deficit, predicting a $105 billion deficit for fiscal year 1989 and $75 billion for fiscal year 1990.

"This is a very optimistic number and it is only valid if we do not have a recession," Mr. Bostian said. "These numbers come from our macroeconomic index which does not signal a recession."

David Littman, senior economist at Manufacturer's National Bank of Detroit, said mandated benefits by Congress is one of the dangers facing the economy, because they impose costs without choice and are "tantamount to a tax on businesses and consumers at a time when consumers appear to be retrenching."

Mr. Littman also said federal spending must slow to 3% or less to conserve resources in the private sector. ■

What the experts predict for 1989 - '90

	GNP		Inflation		90-day T-bills		30-year Treasuries		Federal budget deficit $ billions		Chances of recession	
	2nd half	1st half	2nd half	1st half	2nd half	1st half	2nd half	1st half	fiscal '89	fiscal '90	end '89	in '90
Lincoln Anderson Bear Stearns & Co.	0.5%	1.3%	4.8%	4.0%	8.0%	7.3%	8.3%	7.5%	130	120	NA	NA
David Bostian Bostian Research	1.8	1.5	5.5	4.0	7.5	6.5	8.0	7.5	105	75	30%	50%
Robert A. Brusca Nikko Securities Int'l	2.0	2.5	5.2	5.5	8.3	8.9	8.1	9.3	NA	NA	20	80
Robert Chandross Lloyds Bank/North America	1.2	2.1	5.8	4.9	8.1	8.6	8.5	9.0	150	135	22.5	25
Robert Dederick Northern Trust	0.5	1.0	5.0	4.8	8.2	7.1	8.3	8.2	145	135	50	50
Geoffrey Dennis James Capel	1.8	1.5	5.8	7.0	8.5	8.8	8.5	8.5	146	130	20	40
John Hekman Claremont Economics Institute	2.9	3.4	3.4	3.6	7.2	6.9	8.5	8.1	165	130	5	20
Lacy Hunt Carroll, McEntee & McGinley	2.5	2.3	6.5	7.2	8.5	8.9	NA	NA	144	152	2.5	10
David Levine Sanford C. Bernstein	2.7	5.2	6.0	6.5	8.8	9.6	9.2	9.6	130	120	2	20
Mickey Levy First Fidelity Bank	1.0	1.0	3.5	3.2	7.7	6.8	8.1	7.9	148	160	35	50
David Littman Manufacturers Nat'l Bank/Detroit	1.0	1.5	5.5	5.7	7.8	7.3	8.2	8.1	143	156	35	30
Richard S. Peterson Continental Ill. Bank	2.0	2.0	4.5	4.7	7.8	7.2	8.3	8.3	140	125	10	20
Richard Rippe Dean Witter Reynolds	1.3	1.3	4.8	4.5	7.6	6.8	8.0	7.7	150	135	25	37.5
Georges Rocourt Ganz Capital Mgmt.	2.4	1.5	5.4	6.0	8.4	8.6	8.9	9.3	156	145	20	50
Francis H. Schott Equitable Life Assurance	1.5	1.0	5.5	5.0	7.8	7.5	8.1	8.0	155	150	25	40
Edward Yardeni Prudential-Bache Securities	3.0	3.0	4.0	4.0	8.0	7.5	7.3	7.3	150	125	15	20